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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 7/17/84 **Number:** 169034CA **Due By:** --------------

Subject: Cabinet Council on Economic Affairs - Thursday, July 19, 1984
8:45 a.m. - Roosevelt Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☑	☐
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
______	☐	☐
______	☐	☐
______	☐	☐
Baker	☑	☐
Deaver	☐	☐
Darman *(For WH Staffing)*	☑	☐
Mc Farlane	☐	☑
Svahn	☑	☐
Chapman	☐	☑
______	☐	☐
______	☐	☐
______	☐	☐
______	☐	☐
Executive Secretary for:		
CCCT	☐	☐
CCEA	☑	☐
CCFA	☐	☐
CCHR	☐	☐
CCLP	☐	☐
CCMA	☐	☐
CCNRE	☐	☐

REMARKS: The Cabinet Council on Economic Affairs will meet on Thursday, July 19, 1984 at 8:45 a.m. in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823 (White House)

☐ Don Clarey
☑ Tom Gibson
☐ Larry Herbolsheimer

Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OEOB)

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THE WHITE HOUSE

WASHINGTON

July 17, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the July 19 Meeting

The agenda and papers for the July 19 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The Council will consider three agenda items. The first is the Administration's position on corporate takeover and tender offer legislation. At the Council's June 28 meeting we discussed current legislative proposals to regulate corporate takeovers. Chris DeMuth was requested to draft an appropriate letter to the House Committee on Energy and Commerce addressing the bill reported out of the Wirth subcommittee and to consult with SEC Chairman John Shad. A memorandum and revised letter prepared by Chris DeMuth are attached.

The second agenda item is the Insider Trading Sanctions Act of 1984. Both Houses of Congress has passed slightly different versions of insider trading legislation. Chris DeMuth has prepared a memorandum on this legislation for the Cabinet Council's consideration focusing on the position the Administration should take on this legislation and what provisions we should seek to have adopted in conference.

The third agenda item relates to adjustable rate mortgages. There has been considerable attention recently to the possibility of future significant foreclosures on adjustable rate mortgages. A paper, prepared by Thomas Healey, Assistant Secretary of the Treasury for Domestic Finance, on "Adjustable Rate Mortgage Default Risk" was distributed to Council members on June 26.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

July 19, 1984

8:45 a.m.

Roosevelt Room

AGENDA

1. Administration's Position on Corporate Takeover and Tender Offer Legislation (CM # 481)
2. Insider Trading Sanctions Act of 1984 (CM # 486)
3. Adjustable Rate Mortgages (CM # 479)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 13, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: CHRISTOPHER DEMUTH CD

SUBJECT: Tender Offer Legislation

At its meeting of June 28, 1984, the CCEA discussed current legislative proposals to regulate corporate takeovers. The general conclusion was that the Administration should oppose new federal regulation of both tender offers and defenses to tender offers by "target" corporations.

Several members expressed concern over instances of abusive tactics by incumbent managers threatened by takeover bids. Even here, however, there was general agreement that there are important advantages to state law in this area, and that top priority should be given to avoiding any first steps towards a federal corporation law.

I was instructed to draft an appropriate letter to the House Committee on Energy and Commerce addressing the bill reported out of the Wirth Subcommittee. I was also instructed to consult with Chairman Shad and others at the Securities and Exchange Commission, which has endorsed one of the bills being considered by the House Committee.

The bill reported out of the Wirth Subcommittee on June 29, 1984 (H.R. 5693) is based on the SEC proposal discussed at the CCEA meeting, but in several respects is even worse. The bill would:

-- Extend U.S. margin requirements to foreign purchasers of stock of U.S. corporations (regardless of the source of credit), and create a new private cause of action for those "injured or threatened with injury" by violation of the margin requirements;

-- Extend current tender offer disclosure requirements by requiring disclosure two days <u>before</u> (rather than ten days after) the acquisition of 5 percent of any class of equity securities, and by requiring disclosure of any plans or proposals of the bidder that would affect the communities in which the target corporation operates, or substantially affect its management, labor unions, or employees.

-- Prohibit corporations from increasing the compensation of officers or directors during a tender offer;

-- Generally prohibit corporations from acquiring any of their own securities during a tender offer;

-- Prohibit corporations from issuing securities amounting to more than 5 percent of an outstanding class during a tender offer, except with shareholder approval; and

-- Prohibit corporations from repurchasing stock from holders of 3 percent or more of an outstanding class at a premium over market, except with shareholder approval.

These provisions confirm the worst fears expressed at the last CCEA meeting about the likely tendency of federal legislation in this area.

I have discussed the Wirth Bill with Chairman Shad, Director of Enforcement John Fedders, General Counsel Daniel Goelzer, and other senior staff of the SEC. They agree that certain provisions of the bill are objectionable, especially the new requirement that bidders issue "community and labor union impact statements." But they view other provisions, drawn from their own proposal, as positive or innocuous. In particular, they believe that closing the Williams Act's ten-day disclosure window would not be harmful if this was only to two days after rather than two days before acquisition of 5 percent of stock. They also believe restricting stock issues and repurchases during tender offers would eliminate current abuses that deter tender offers, and that states have not been aggressive enough in this area. Finally, they believe the Commission should support at least some of the recommendations offered last year by its own blue-ribbon Advisory Committee on Tender Offers.

Following these and other discussions, I remain persuaded that the Administration should oppose the current legislative proposals strongly and in their entirety. While one can imagine, in the abstract, one or two beneficial adjustments that might be made in tender offer law, any legislation on the subject likely to emerge from the Congress this year will be certain to do substantial harm to the economy. The one major positive step that could be taken--abolition of the Williams Act--is politically infeasible.

The case against the Wirth Bill is set forth in detail in the attached draft letter to Chairman Dingell. If the CCEA approves this letter, a conforming letter should be sent to Chairman Garn in the Senate, where restrictions on "greenmail" and "golden parachutes" have been added to a pending banking bill we otherwise support.

Attachment

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

DRAFT

Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U. S. House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

On June 29, 1984, a proposed bill, H.R. 5693, comprised of two titles, "Equity in Foreign and Domestic Credit" and "Tender Offer Reform," was reported out of the Subcommittee on Telecommunications, Consumer Protection, and Finance of your Committee. I am writing on behalf of the Administration to express our views on this proposal.

The purpose of H.R. 5693 is to regulate corporate takeovers by restricting the conduct of both bidders for corporate control and "targets" of takeover bids.

Title I would amend the Securities Exchange Act of 1934 (the "Exchange Act") to extend to foreign persons the margin requirements on credit transactions for the purchase or carrying of United States securities, irrespective of whether such foreign persons borrowed from foreign or domestic lenders. The purpose of this provision is to end the perceived inequality whereby foreign borrowers, using foreign lenders, are able to leverage more fully their purchases of securities of United States corporations than are U.S. citizens. Title I would also create an express private cause of action for issuers and others "injured or threatened with injury" by violation of the margin requirements in connection with the purchase or carrying of more than 5 percent of any class of equity security or with a tender offer by persons who would hold 5 percent or more of any class of equity security following such tender offer.

Title II would further amend the Exchange Act to require that Section 13(d) tender offer disclosures be made at least two business days <u>prior</u> to any acquisition of equity securities that would result in ownership of 5 percent or more of the outstanding shares of any class of an issuer's equity securities, and by requiring disclosure of any plans or proposals of the filing person that would affect the communities in which the issuer operates, or substantially affect its management, labor unions, or employees.

Finally, Title II would also amend the Exchange Act to restrict or prohibit certain actions by corporations faced with threatened takeover:

-- Corporations would be prohibited during a tender offer from increasing the compensation of any officer or director;

-- Corporations would be prohibited during a tender offer from acquiring any of their own securities, other than pursuant to ongoing programs conducted in the ordinary course of business;

-- Corporations would be prohibited during a tender offer or proxy contest from issuing securities amounting to 5 percent or more of an outstanding class, except with shareholder approval; and

-- Corporations would be prohibited at any time from repurchasing securities from holders of 3 percent or more of an outstanding class at a premium over the prevailing market price, except with shareholder approval or unless an offer is made to all holders on equal or better terms.

The Administration has carefully reviewed these proposals and is strongly opposed to their enactment. We believe H.R. 5693 would not end takeover "abuses" or serve any other desirable purpose, but rather would work to the disadvantage of the investing public by reducing the frequency of corporate takeovers and increasing the volume of socially wasteful takeover-related litigation. In addition, we believe H.R. 5693 would be an unwarranted intrusion into matters traditionally governed by state law, and constitute a major step towards imposition of a substantive federal corporation law. I will discuss these two concerns generally before turning to our specific objections to the provisions of H.R. 5693.

General Considerations

Corporate takeovers perform several beneficial functions in our economy. First, they provide a means--sometimes the only feasible means--of policing management conduct in widely held public corporations. Second, they help identify undervalued assets and permit shareholders to realize the true value of their investments. Third, they can reallocate capital and corporate assets into higher-valued uses; enable merger partners to generate joint operating efficiencies; and provide companies with access to financial, management, and other resources not otherwise available.

Takeovers are generally good for shareholders of both bidder and target corporations. The best available data indicate that the average tender offer that leads to a merger results in an appreciation in the value of the combined enterprise equal to

about 10.5 percent of the initial value of the merged companies. Shareholders of the acquired company realize a premium for their shares averaging 38 percent of the pre-acquisition market price of the target; acquirors enjoy smaller, but significant, gains. The division of gains between bidder and target shareholders does not differ substantially between mergers effected by tender offers for "any and all shares" and "two-tier" offers (tender offers followed by a merger as a lower price). Partial tender offers that do not result in a merger lead to somewhat smaller, but still substantial, gains. And these figures understate the economic gains from corporate takeovers, since the pre-takeover market prices for corporate securities often include some premiums anticipating future acquisitions.

Unfortunately, current federal regulation of tender offers works to the disadvantage of shareholders by deterring takeover bids. The disclosure requirements of the Williams Act oblige prospective bidders for corporate control to reveal their plans before taking full market advantage of them through stock acquisitions. While intended to protect shareholders of target companies, in practice these requirements have the opposite effect. First, valuable business information accumulated by bidders (for example, information on the identity of poorly managed corporations with undervalued stock prices) is partially appropriated for use by others--which discourages investment in the discovery of such information and in the risky activity of initiating takeover bids. Second, premature disclosure of takeover plans gives incumbent managements the opportunity to delay and engage in a variety of defensive abuses, thereby denying shareholders the opportunity to obtain a premium for their shares. In both cases, the result is to increase the costs and delays and to decrease the potential returns of takeover bids--and thus to reduce their frequency.

The number of tender offers declined nearly 10 percent following enactment of the Williams Act in 1968 and its amendment in 1970. The number of offers increased steadily from 1970 until 1979, although it did not surpass the 1968 level until 1977. It dropped off sharply again in 1980, the year in which the SEC proposed another elaborate set of rules governing tender offers. At a minimum, these facts suggest that we should proceed with caution in proposing new federal laws that could make takeover attempts more difficult and less profitable.

Proposals to regulate potentially abusive defensive tactics by target corporations raise a separate set of issues. Clearly there have been cases where incumbent managers have seriously abused shareholder interests. We believe, however, that there are two important reasons to doubt the utility of federal law in this area. The first is that singling out particular categories of management conduct for uniform restriction or prohibition is highly problematic. Actions taken in the course of takeover contests (including those addressed by H.R. 5693) may have legitimate business purposes as well as the potential for abuse,

and determining whether they are legitimate or illegitimate in different circumstances often involves close questions of business judgment. Furthermore, some defensive tactics, such as "greenmail," are a positive inducement to takeover attempts; as a result, banning them may be good for one set of shareholders after a takeover attempt has begun, but bad for the generality of shareholders in the longer run. And finally, even where certain kinds of defensive tactics tend to discourage takeover attempts, banning them may only deflect the energies of threatened managers to other tactics that are less restricted but whose economic effects are worse--such as the "crown jewels," "pac-man," and various "lock-up" and "scorched earth" defenses, plus many others not yet invented.

The second reason for skepticism is that state corporation law is very well suited to regulating the management of business corporations, in this as in other areas. In the United States, we have traditionally relied on state corporation law and market competition to discipline corporate managers who act against the interests of their shareholders. The empirical evidence suggests strongly that state corporation law benefits shareholders because market competition impels corporations to select states of incorporation that maximize their share values--not, as is sometimes uncritically assumed, state laws that maximize management discretion at the expense of share values. Diverse state corporation laws accommodate the wide diversity in the sizes, market strategies, product and service offerings, and other characteristics of our nation's business firms. They also permit a market test of alternative regulatory approaches to new and complex questions of corporate governance, such as those presented by recent takeover contests. In contrast, federalizing corporation law forecloses the market in state charters, eliminates the possibilities of different management approaches in different corporate circumstances, and prevents market competition from working to increase shareholder wealth.

Given the natural advantages of state law in this area and the success of state law in the past, we believe a strong presumption exists against the establishment of federal corporation law, even in part. Federal regulation of corporate management should be considered only where a serious market failure of national dimensions has occurred, or where some broader national purpose is to be served. In the case at hand, we believe that no broad national purpose has been identified, and that abusive defensive tactics can be--and indeed already are being--effectively addressed by state law.

To summarize these introductory points, our view is that no systematic abuses have been identified that would justify further federal restrictions on takeover activities. To the contrary, in light of the overwhelming evidence that takeover activity produces significant economic benefits, we should be seeking ways to minimize government disincentives to takeover bids and tender offers. With regard to potentially abusive defensive tactics, we

believe these are to a large extent the result of too much federal regulation of bidders rather than too little regulation of targets--and that decisions concerning which of these tactics should be restricted, in what circumstances, and to what degree, are far better suited to state than to federal law. With these considerations in mind, we turn to the specific provisions of H.R. 5693.

<u>The Provisions of H.R. 5693</u>

Title I of H.R. 5693, while billed as promoting "equity in foreign and domestic credit," appears aimed instead at reducing the frequency of attempted corporate takeovers. The historical purpose of the margin requirements under Section 7 of the Exchange Act has been to prevent a stock market collapse of the sort experienced in 1929, when margin calls in a rapidly declining market snowballed into a selling panic. By providing a cushion of excess collateral, the margin rules can be used by monetary authorities to avoid the need to liquidate leveraged stock positions in a declining market. Section 102 of the proposed bill would distort this purpose by extending the margin requirements to wholly foreign credit transactions solely to handicap foreign persons attempting to acquire interests in U.S. corporations.

The Administration believes that there is no justification for extending margin requirements to foreign credit transactions at this time. There is no evidence that such transactions are in any way destabilizing to United States securities markets. If equity between U.S. and foreign bidders is desired, the best way to achieve it would be to exempt corporate acquisition transactions from the margin regulations altogether. Stock acquired in an acquisition is rarely resold in market transactions; there is, therefore, little reason to subject such acquisitions to margin requirements. Moreover, the existing margin rules bias the form of acquisition against stock acquisition and in favor of asset purchases (which are not subject to limitations on leverage) or leveraged buy-outs (which are financed by collateralizing assets). Since a hostile takeover can only be accomplished by stock purchase, the existing margin rules work against corporate takeovers; extending their reach in the name of "equity" will only make matters worse.

The other provisions of Title I--creating a private right of action for issuers and other persons "injured or threatened with injury" by margin violations in connection with certain transactions--are also unjustified. These provisions would overturn existing case law rejecting a private cause of action, and serve only to create yet another ground for wasteful "defensive" litigation by incumbent managements. We are convinced that, far from being injured by margin violations, issuers and their shareholders are benefited by persons who buy and hold their stock, however such purchases are financed. We are, in fact, mystified as to how damages could ever be awarded

under the proposed bill to plaintiffs who have sustained no economic injury.

We have similar concerns regarding the provisions of Title II that would amend Section 13(d) of the Exchange Act. Requiring disclosure of a buyer's intention two business days prior to crossing the Section 13(d) threshold would make it more difficult and expensive for bidders to mount takeover attempts, and reduce the gains to a successful bidder from any appreciation in the value of target company shares. We do not consider the rapid accumulation of shares in the market to be an abuse. The effect of this proposal, and similar proposals to close the 13(d) disclosure window, is unambiguous and undesirable--a reduction in takeover attempts and tender offers.

Additional disclosure requirements as to plans or proposals that would affect the communities in which the issuer operates, or substantially affect its management, labor organizations, or employees, would serve principally as a device to allow target managements to battle unwanted takeover attempts with delaying litigation and by imposing substantial costs on bidders. In particular, target managements could engage in lengthy discovery directed at exposing all of the strategic planning of the offeror. Not only would incumbent managements have a longer period in which to undertake defensive actions that may be injurious to its shareholders, but some offerors would be deterred altogether by the prospects of costly litigation and premature disclosure of business strategies.

Title II would also prohibit new or amended compensation agreements between a target corporation and its officers and directors during a tender offer. Such a prohibition would be an unprecedented, unnecessary, and unwise intrusion by the federal government into corporate management. The ability to offer key corporate managers revised compensation proposals can be beneficial to shareholders in at least two ways. First, it may be necessary to induce key managers to remain with the company during periods of great uncertainty about the corporate future. Second, it may be a useful tool to minimize the incentive for corporate managers to engage in defensive tactics that would be seriously detrimental to shareholder interests. In both cases, such agreements serve an important purpose--to bind the interests of managers and shareholders at a time when outside "threats" to incumbent managers might otherwise induce them to act contrary to the interests of their shareholders.

The prohibitions on target corporations' purchasing their own securities and issuing new securities during tender offers may likewise be disadvantageous to target company shareholders. Purchases by the target by a self-tender offer may give shareholders an attractive alternative to a low bid by an outsider. Sales of securities to a third party may help prompt a bidding war. Even if these devices are abused, prohibiting them altogether may simply redirect ever-resourceful managements into

other defensive strategies that are even less desirable. A defensive stock issue at least has the virtue of placing a significant block of shares in the hands of a single owner, who may then have the power and incentive to police the target's management. An alternative to defensive stock issus may be the sale of the target's premier assets--its "crown jewels"--at a bargain price, which lacks any such virtue.

Repurchases from a significant shareholder at a premium over market--so-called "greenmail"--presents a more difficult case, but even prohibition of greenmail may be contrary to the interests of target company shareholders. First, the possibility that shares may be resold to the target in the event of an unsuccessful takeover attempt raises the expected value--and hence the likelihood--of takeover activity. Prohibitions on repurchases may thus deter takeover offers to the disadvantage of all market participants. Second, evidence indicates that even when "greenmail" takes place, shareholders' stock appreciates, perhaps because of the disciplining effct on management. This technique may be abused, but policing it should be a straightforward matter of state corporation law, and we note that many states have been active in this area. Given the present state of our knowledge, we believe it would be unwise to regulate repurchase transactions under federal law.

We have no objection to provisions of Title II that propose to treat banks, associations, and other entities that exercise fiduciary powers in the same manner as broker-dealers under Section 14(b) of the Exchange Act.

For these reasons, we believe enactment of H.R. 5693 would be a significant backward step for securities and corporation law in the United States, and we urge that it be rejected.

Sincerely,

David A. Stockman
Director

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 13, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: CHRISTOPHER DEMUTH CD

SUBJECT: The Insider Trading Sanctions Act of 1984

Both Houses of Congress have passed slightly different versions of a bill entitled "The Insider Trading Sanctions Act of 1984." The House version passed last year on the suspension calendar without objection from the Administration. The Senate version (S. 910), sponsored by Senator D'Amato and co-sponsored by Senator Garn, passed on a voice vote earlier this month. Both bills are supported by the Securities and Exchange Commission, and the securities industry is generally unopposed.

S. 910 would amend the Securities Exchange Act of 1934 to permit the SEC to bring a civil damages action for up to three times the gains made (or losses avoided) from purchasing or selling a security "while in possession of <u>material nonpublic information</u>" in violation of the Act or SEC regulations thereunder (emphasis added). The term "material nonpublic information" is not defined.

The bill is objectionable for two reasons. First, although it purports to affect only the remedies available to the SEC in "insider trading" cases, in practice it would greatly expand the scope of "insider trading" prohibitions to the detriment of all who buy and sell securities. Second, the bill would make certain breaches of private contracts illegal, and substitute public enforcement by the SEC, at public expense, for private enforcement by contracting parties.

Any restriction on trading in securities markets using all information available to anyone imposes social costs. Such restrictions prevent market prices from reflecting all available information and, therefore, cause buyers and sellers to bear greater risks of adverse price movements. This extra risk for persons trading in securities markets is reflected in lower securities prices and diminished national wealth. We should not limit the use of economic information unless necessary to remedy some other market defect or serve some broader public purpose.

The SEC prohibits trading by corporate "insiders" in securities of their own corporation. The purpose of this prohibition is to prevent insiders from suppressing corporate information or

causing fluctuations in the prices of corporate securities in order to create opportunities for profitable trading. The "insider trading" prohibition has both benefits and costs, and whether the benefits are worth the costs is a subject of lively controversy among economists.

Regardless of the merits of this debate, there is no justification for extending trading prohibitions to those who are neither insiders themselves nor have received tips from insiders. Outsiders may produce, or acquire from other outsiders, valuable information about the prospects of a corporation that is not known to other traders in the corporation's stock. Restricting trading based on such "nonpublic" outside information has all costs and no benefits: it reduces the efficiency of securities markets but does not (and by definition cannot) prevent corporate mismanagement and stock manipulation.

Unfortunately, in recent years the SEC has attempted to expand its insider trading prohibitions to encompass trading by corporate outsiders based upon "material nonpublic" information. In the Chiarella case (1980), for example, it prosecuted the employee of a financial printer who had advance access to announcements of corporate takeover bids, and who purchased stock in the target corporations prior to public announcement. The Supreme Court reversed the printer's conviction, holding that he was not a corporate insider, had received no confidential information from inside the target corporation, and had no duty to disclose the "nonpublic" information he had obtained to those from whom he purchased the corporation's securities.

In Chiarella, the Court left open the question whether the printer might have been convicted if he had breached a fiduciary duty to the acquiring corporation whose takeover plans he had read. The Second Circuit recently answered this question in the affirmative in the Newman case (1983), involving employees of Morgan Stanley who leaked information on prospective takeover targets and merger partners of Morgan Stanley's clients. Under usual rules of statutory construction, S. 910 would be treated as a legislative ratification of the Newman decision, rendering illegal (and subject to triple-damage civil liability) any trade based on "material nonpublic information" where the SEC could show that the trader had violated a fiduciary duty to someone.

This would be a lamentable development. There is an endless array of circumstances where valuable information on the prospects of corporations is created or acquired by limited numbers of people entirely outside the corporations--by competing firms, by firms in supplier and purchaser markets, by econometric forecasting firms, by newspapers, and so forth. In many cases, individuals who come into possession of such information have contractual duties to keep it confidential and to refrain from using it for their own profit--just as contractual restrictions on the use of all manner of "trade secrets" are common between firms and their employees and outside consultants.

If such fiduciary duties are breached, ample remedies are available at state contract and trust law. There is no need for a federal regulatory agency such as the SEC, with treble-damage sanctions at its disposal, to enforce them at public expense, any more than the SEC should enforce other types of confidentiality agreements. Policing such contracts has no basis in the traditional justification for the insider trading prohibition. Other than enforcing private contracts on the complaint of contracting parties, the government should not retard the diffusion of such information to the market at all.

Moreover, one must worry that a prosecution-minded agency such as the SEC will be eager to step in and enforce "fiduciary" duties that the private parties themselves had not even known existed. Just as the SEC has adopted highly expansive notions of what constitutes "inside" information, so it will adopt highly expansive notions of what constitutes a "breach of fiduciary duty"--all in the name of promoting "fairness" (meaning enforced equality of information) in securities trading.

A case in point is the SEC's outrageous censure of Raymond Dirks, the securities analyst who exposed the Equities Funding fraud. The Commission appears to have disavowed the case since getting reversed on it by the Supreme Court last year. It is worth recalling, however, that the heart of the Commission's case was that Dirks, upon discovering the fraud at Equity Funding and the fact that its stock was greatly overpriced, thereby unwittingly acquired a general obligation to the public-at-large that could be enforced against him by the government.

Supporters of S. 910 claim that it would not overturn the Supreme Court's decision in Dirks v. SEC. There is good cause for skepticism on this point. The bill, by making illegal any securities transaction based on "material nonpublic information" so long as a breach of duty can be discovered somewhere, will provide powerful impetus for the emergence of a general public duty to disclose all material private information about the economic prospects of publicly traded corporations.

Strictly on the policy merits, S. 910 ought to be strongly opposed. Since the bill has been supported by allies of the Administration, and has probably progressed too far for opposition to be effective, we ought to insist that a definition of "material nonpublic information" be added in conference--one that would restrict the term to the original conception of information held by corporate insiders and their direct, beneficial, tipees.